RICHFIELD INTERNATIONAL LAND & INVESTMENT CO. LTD.

v.

THE COMMISSIONER OF INLAND REVENUE

COURT OF APPEAL, HONG KONG
LORD JAUNCEY OF TULLICHETTLE
LORD ACKNER
LORD ROSKILL
LORD GOFF OF CHIEVELEY
LORD LOWRY
[PRIVY COUNCIL APPEAL NO. 9 OF 1989]
3 OCTOBER 1989

REVENUE LAW: *Income tax - Real Property - Taxpayer - Company incorporated for the purpose of long term real property investment - Owning real properties in Hongkong and in California - Sale of two Hongkong properties and submission to profit tax (income tax in Malaysia) - Subsequent sale of other properties and also submission to profits tax in respect of one of them - Recording in accounts of these disposals as constituting realizations of capital assets except for one of them - No reinvestment of proceeds in foreign property - Whether disposals constituted realization of capital assets or of trading stock - Onus of proof on appellant.*

The taxpayer-company was incorporated on 22 September 1972 as a long term property investment private limited company. In November 1972 it became a public limited company but its decisions were at all material and relevant times actuated by the intentions of its "governing mind", one Mr. Y.M. Wong, the chairman and executive director of the taxpayer-company.

The taxpayer-company acquired the following properties in Hongkong in 1972:

(i) A small shop in Tai On Building which was unlet throughout;

(ii) Lungcheong Villa;

(iii) eight flats (Kellet Heights) rented out for approximately four and six years before sale;

(iv) the Gardena Court properties comprising 15 flats which were rented out for approximately seven years before sale;

(v) Lucernce Towers and Orange Plaza, in Los Angeles USA owned through a wholly owned subsidiary and fully let.

The taxpayer company also owned indirectly, property investments in California.

The taxpayer-company then embarked on certain sales at the following times:

(a) The Tai On shop in 1973, four months after acquisition;

(b) the Lungcheong Villa, ten months after acquisition;

(c) one unit of Kellet Heights in 1976 about four years after acquisition;

(d) the remaining seven units of Kellet Heights, about six years after acquisition;

(e) the Gardena properties in January 1980 about seven years after acquisition.

All the sales resulted in a profit.

Except for the Kellet properties, the disposals of these properties were recorded in the accounts as disposals of capital assets. Regarding the Kellet properties the profits were recorded in the profit and loss account. Capital allowances were also claimed and obtained on the Kellet and Gardena properties. There was no evidence that Kellet Heights had been sold for the purpose of re-investing the proceeds in real property in the USA.

Additional assessments to profits tax (income tax in Malaysia) were raised in respect of the Tai On shop and Lungcheong Villa. Assessments to profits tax were also raised in respect of the Kellet and Gardena properties.

The taxpayer-company submitted to profits tax on the sales of the sales of the Tai On, Lungcheong and Kellet properties but appealed to the Board of Review against assessment to profits tax in respect of the Gardena properties.

The Board of Review held that the initial intention of the taxpayer-company was to purchase and retain the Hongkong properties as long term investment but they further concluded that at least by April 1978 Mr. Y.M. Wong looked upon the said properties as trading stock, the crucial factor being, the submission to tax by the taxpayer company. Had it not been for this crucial factor the board would have concluded that the sales constituted a realization of capital investments.

Held:

[1] The jurisdiction of the Privy Council was restricted to appeals only on questions of law. As such the question (as regards the finding of fact) was whether the Board of Review (or other body charged with the hearing of appeals against assessment to tax) had acted without any evidence or upon a view of the facts which could not reasonably be supported (*Edwards v. Bairstow* [1956] AC 474 HL, at p. 29);

[2] As the Board of Review had not drawn an inference for which there was no foundation in fact or which could not reasonably be sustained by the facts which were found, the decision of the board could not be reversed.

[Appeal dismissed.]

Cases referred to:
International InvestmentLtd v CG of IR [1950-1985] MSTC, 38PC
Saloman v Salomon &Co.Ltd [1897] AC 22 HL
IRC v Duke of Westminister [1936] AC 1
Lim Foo Yong Sdn. Bhd. v. Comptroller-General of Inland Revenue [1986] STC 255
E v DGIR [1950-1985] MSTC 106
River Estates Sdn Bhd v DGIR [1950-1985] MSTC 64
Chu Lip Kong v DGIR [1950-1985] MSTC 58

Legislation referred to:
Inland Revenue Ordinance [HK], ss. 14, 68(4)

Editorial Comment by Mr. James C.Y. Loh, Advocate & Solicitor of the High Court:

This case represents certain interesting facets as to practice (both law and accountancy and tax law which are of great practical relevance not only to those who advise on tax matters but also property investment managers and landed proprietors with a rather varied real property portfolio. It also highlights the dangers of adhering to a supposedly rigid framework of do's and don'ts when dealing with real property acquisitions and subsequent sales. The reason is that although marking a tick in the “No” or “Yes” box of pros and cons

would be useful in focussing on the tax probables and improbables, one should not ignore the human element e.g., what passes through the mind of the person at the helm of the organisation - "the governing mind" - to use the phrase of the HongKong Court of Appeal. In Malaysia, too with a number of family companies going public, the "governing mind" (e.g., "the old man") of the company - notwithstanding its new public image - might play a crucial role in deciding whether or not the transaction is treated as a taxable transaction exigible to income tax.

This commentator proposes to approach the case first on the practice aspect, and then on the legal aspect although both overlap.

The Practice Aspect:

If there is any lesson to be learnt from this case it is that if you have multifarious real property investment portfolio and you find yourself facing an income tax assessment (profits tax assessment in HongKong) never, tamely submit to tax even passively unless you are satisfied that your case is virtually hopeless; or you have proclaimed that you are now in the business of property dealing; or you cheerfully agree to submit to the income tax assessments! In the *Richfield* case what spoilt things from the start was that having recorded in the accounts the proceeds from the sale of the Tai On shop and the Lungcheong Villa as constituting a capital gain, the taxpayer - company then acquiesced tamely to the imposition of income tax. This was done notwithstanding (or was it because?) the Hongkong Revenue described these transactions as "property dealing".

It is not merely that one may change one's mind later on but also that the Revenue may use the evidence or rather submission to tax on previous transaction as a lethal weapon; as was indeed done in the *Richfield* case where the Hongkong Board of Review emphatically decided that the submission to income tax by the taxpayer-company as to the Tai On, and Lungcheong transactions was indeed the turning point which titled the scales in favour of the Revenue.

The Board of Review (whose decision was upheld by the Privy Council) had candidly stated that if not for these submission to tax, it would have found for the taxpayer-company.

Another lesson to be learnt - which should have in fact have been learnt since the case of *International Investment Ltd. v. CG of IR* [1950-1985] MSTC, 38, PC at p. 41, is that one should not make admissions in the accounts or returns as to the income nature of the transaction unless one is of course an avowedly self proclaimed property dealer e.g., housing development companies. In the *International Investment Ltd*. case (which their Lordships characterised as a borderline cast at p. 42) the taxpayer-company entered the item work in progress on the subject matter of the transaction (i.e., the building in question) in the Balance Sheet as being a "current asset" (i.e., trading stock) this contradicted another entry which showed that the land on which the building stood was a "fixed asset". The Privy Council regarded this a vital factor.

In the *Richfield* case, the accounts described the gain on the sale of the Kellet properties as constituting profits in the Profit and Loss account presumably adjusted for tax purposes. This was recognized by the Court of appeal and the Privy Council as being of important relevance. It is reasonably clear from the way the Privy Council regarded the decision of the Board of Review, that the *Richfield* case was a borderline case.

The accounts of course are not conclusive. The *Richfield* case shows this to be so; the Tai On and Lungcheong transactions were described in the accounts as resulting in a capital gain but this description by the accountants was over-whelmed by the subsequent submission to income tax.

The third lesson to be learnt is that if there is a "governing mind" of the company (the "big boss" or the "old man") who is in fact the psyche and brains of the company, one should consult him before the plunge is made and also advise him accordingly to seek advice on the tax implications; otherwise one might find oneself plunging into the oceanic waters of trade, instead of coming to rest in the reservoir of capital accumulation or capital realisation

In the *Richfield* case the Board of Review found as a fact that the "governing mind" who was the Chairman and the executive director of the taxpayer-company that at least by April 1978 "Mr. Y.M. Wong looked upon the Hongkong properties of the company as trading stock" although they also found as a fact that the "**initial** intention of the company" was "to purchase and retain the ... properties as long term investments." The emphasis is mine.

Those who work in or who deal regularly with the firm or company know who is the "governing mind" and ought from the tax angle to ascertain whether he proposes to continue with the investment policy or move into the top gear of trading. Perhaps the officers of the company did so for as regards the Kellet properties the proceeds from the sale thereof were entered in the profit and loss accounts. More importantly was the decision to submit to tax as regards the first two sales namely the Tai On and Lungcheong transactions as also with reference to the Kellet properties in respect of which "a very substantial amount of tax was paid ...".

The fourth lesson to be learnt is that one should also take into account one's portfolio of foreign or overseas properties. The taxpayer-company owned properties in the USA and the Privy Council took note of the fact that the proceeds from the sale of the Kellet properties were not reinvested in the USA properties. The Hongkong Court of appeal was aware of the fact that the company had investment properties in the USA; so had its newly acquired wholly owned subsidiary.

It would be interesting to observe whether the Malaysian Courts will take the same view and approach. Perhaps the Privy Council and the Court of Appeal regarded Hongkong as one of the international centres of trade and investment capital and that being the case funds used for overseas investment should also be regarded as a relevant factor in cases of this nature. This is perhaps one of the symptoms of an ever growing trend towards the internationalisation of national economies. Peter Drucker in his article in the London Economist (21-27 October 1989) refers to this trend and to the aspect of "reciprocity".

The fifth lesson to be learnt is that tax planners and tax advisers should no longer rely entirely on *Saloman v. Salomon & Co. Ltd.* [1897] AC 22 HL as if it were holy cow, that is to say in the field of taxation, when there is in the words of the Hongkong Court of Appeal - impliedly approved of by the Privy Council - in the *Richfield* case a "governing mind" whose dictate holds sway in the company. *Salomon's* case of course decided that a company is a separate legal entity from the "governing mind" e.g., Mr. Salomon.

Amidst the flux and flow of fluid and ever changing economic conditions British Judges nowadays appear to be gradually shifting towards a more realistic approach e.g., preferring the substance over from approach. In one of the substance versus form cases (which the writer prefers to describe as the overall scope and intent cases). Lord Diplock observed as follows:

> The kind of tax avoidance schemes that have occupied the attention of the Courts in recent years, however, involve inter-connected transactions between artificial person limited companies, without minds of their own but directed by a single master mind". See *IRC. v. Burmah Oil Co. Ltd*. [1982] STC 30, HL at 32.

His Lordship was contrasting the position with *IRC v. Duke of Westminister* [1936] AC 1, HL where as Lord Diplock observed there was "a simple transaction between two real persons reach with a mind of his own."

The Revenue, however, are sadly mistaken if they think that the tax knife cuts only one way. In *Lim Foo Yong Sdn. Bhd. v. DGIR* [1986] STC 255, PC (a Malaysian Privy Council case) cited by their Lordships the tax knife this time pointed at the throat of the Revenue. In the *Lim Foo Yong Sdn. Bhd*. case the Federal Court described Mr. Lim Foo Yong as the 'alter ego'of his private company, Lim Foo Yong Sdn. Bhd. Although the decision of the Federal Court was reversed, the Privy Council (which upheld the appeal of the taxpayer) evidently approved of this particular line of thought for they described in some detail the business activities of Mr. Lim Foo Yong. Mr. Lim Foo Yong was in the business of being a hotel and restaurant proprietor and not that of a property dealer.

In Malaysia the Federal Court also has evidently adopted this more realistic overall approach of looking at the scope and intent of the transactions or of the statute; see *E. v. DGIR* [1950-1985] MSTC 106 at 121.

Law:

As can be seen the issues of law and practice overlap, the last topic under *"Practice"* being in fact more or law.

As regards the discussion on law, the commentator proposes to compare and contrast this case with *Lim Foo Yong Sdn. Bhd. v. DGIR*

At first sight these two Privy Council cases are not easy to reconcile there being points of convergence. As in *Lim Foo Yong's* case there were previous sales the proceeds of which were subject to income tax. There is no direct statement as to whether there was a submission to income tax by Lim Foo Yong Sdn. Bhd. This is to be assumed because if there had been appeals or at least compromises there would have been reference to either. In *Lim Foo Yong's* case, however, the Privy Council held that the Special Commissioners had overstressed the importance of previous sales an constituting the 'crux of the case' and this, said the Privy Council amounted to a misdirection in law (see p. 261 of 1986, STC). A compromise of course does not amount to an admission of liability.

The second point of convergence is that both Lim Foo Yong Sdn. Bhd. and Richfield etc. Co. Ltd. were originally engaged in carrying on the business of investment in land as a long term investment. In the case of Lim Foo Yong and his *alter ego* land was purchased and developed for the purpose of furthering the hotel and restaurant businesses in other words, the land holdings were capital investments yielding of course income from the hotel and restaurant businesses. As regards Richfield, the Board of Review had found as a fact that it was initially carrying on the "business of long term property investment". Richfield e.g., derived its rental income from the Kellet and Gardena properties for approximately four six and seven years respectively.

As in both cases, the crucial issue was whether the taxpayer had converted a capital investment into trading stock. There is no doubt that the Garden properties were originally a capital investment and similarly with the Merlin properties (in *Lim Foo Yong's* case).

A closer scrutiny of the *Richfield* case, however, shows that it can and ought to be distinguished from the *Lim Foo Yong* case *viz*:

1. ***Sale versus Sale & Leaseback:***

To begin with the sale of the Gardena properties in the *Richfield* case - as indeed with the previous sales of Tai On, Lungcheong and Kellets - were out and out sales as a result of which ownership and possession passed out of the hands of Richfield to the purchaser. They were therefore no longer retained by the taxpayer as capital investments. On the other hand, in the *Lim Foo Yong* case the Merlin properties were the subject matter of a sale and leaseback arrangement (see e.g., p. 262 of 1986, STC). In a sale and leaseback arrangement the ownership of the capital asset passes out of the hands of the vendor or seller but the possession remains with him to be used by the vendor for the purpose of his business. Indeed in *Lim Foo Yong's* case part of the package arrangement was that the vendor would *repurchase* the capital asset at the end of ten years at the same price. This further reinforces the view held by the Privy Council that it was not a sale of trading stock but was for the purpose of further expanding the taxpayer's business.

The Special Commissioners, however, misunderstood the effect of the sale and leaseback (cum repurchase) package arrangement and this elicited the following criticism of the Privy Council at p. 262 of 1986, STC:

> As Counsel for appellant has submitted, the arrangement of a sale and lease back is by no means an unusual method of raising money. In this case the contemporaneous repurchase agreement produced substantially the same result as a mortgage and it could hardly be contended that, if this money had been raised by the more conventional but also more expensive method of a mortgage, income tax would be payable on any part of the money raised as a profit from trade ...". The whole tenor of the transaction indicates an intention on the part of the appellant *to retain the asset,* the hotel and profit element in it, as a capital asset and to describe finance raised in this way, which in any even was subject to a liability to pay back exactly the same sum on a repurchase, to which the vendor was contractually bound from the inception, as a profit from trade, is in their Lordship's judgment, a misuse of language". The emphasis is the commentator's.

2. ***Outright Sale versus Reconstruction of Capital:***

Here again in the *Lim Foo Yong* case the Special Commissioners - after initially proceeding along the correct lines - went on to misunderstand the effect of a scheme of reconstruction. Consequent on the sale and least back (cum repurchase arrangement) the taxpayer for the purpose of raising further capital (see p. 258 of 1986, STC) engaged in a scheme of reconstruction. Lim Foo Yong Sdn. Bhd. set up a subsidiary hotel company (Merlin Hotels Malaysia Ltd.) Under the schme of reconstruction Lim Foo Yong Snd. Bhd. assigned the lease of the Hotel Merlin properties under the sale and leaseback arrangement, the right to repurchase the said properties, furniture and fittings of Hotel Merlin and shares in the Cameron Highlands Hotel Co. Ltd. and shares in Hotel Merlin Ltd. to Merlin Hotels Malaysia Ltd. in exchange for shares; in other words it was a mere exchange so as to raise more capital which the Revenue nevertheless treated as giving rise to a trading profit. Part of the shares received by Lim Foo Yong Sdn. Bhd. were sold at a profit which the Revenue subjected also to income tax.

The Special Commissioners themselves found that the purpose of the reconstruction was to raise further capital "for further expanding the hotel" (see p. 262 of 1986, STC where Their Lordships noted this finding of fact).

Whilst acknowledging - on the basis of decided authorities - that " ... an exchange of securities in a reconstruction constitutes a realisation of the property exchange ..." went on to distinguish this form an outright sale as follows: (see pp. 263 & 264 of 1986, STC):

> ... the transferring company retains as interest in the property exchanged through its shareholding in the new company and the transformation of a direct property interest into a shareholding tells one nothing about whether the transaction is a trading transaction or merely a change of investment". The emphasis is that of the commentator.

It would be reasonably clear by now that this topic follows from the first, a scheme of financing designed to expand the capital base of an investment business is not necessarily an adventure in the nature of trade having regard to the nature of the business, its requirements and its needs. As the Privy Council in *Lim Foo Yong's* case pointed out;

> an investment does not turn trading stock because it is sold.

Thus the sale of an investment and the reinvestment in another investment asset may mean a mere change in investment; (see p. 259 of 1986, STC). There is no evidence of this in the *Richfield* case and as has been pointed out previously the Privy Council, found no evidence or finding that the sale of the Kellet properties was for the purpose of reinvestment in the foreign properties. This is unlike the *Lim Foo Yong* case where the sale and lease back (cum repurchase) followed by the reconstruction of capital represented the expansion of the hotel and restaurant business. There was ultimately no substantive divestment of ownership for gain. Rather it was a ingenious scheme for financing, which was also tax efficient.

Additional Points of law:

Interval of Time Between Sale and Acquisition of Properties:
Although this need not be a vital factor the circumstances of the case may render it of crucial relevance. In the *Richfield* case the Tai On shop (which was unlet) was sold four months after acquisition and the Lungcheong Villa ten months later. This was treated by the Hongkong Board as comprising one of the factors forming the basis of "the facts from which the board drew the crucial inferences".

Thus whether this point is of primary or collateral relevance must depend on the circumstances of case.

Onus of Proof:
The Privy Council dismissed the appeal by Richfield against the imposition of income tax by the Board of Review not because the conclusion of the Board of Review on the facts was a reasonable one. This stems from the principle that there are no appeals on facts against the decision of the fact finding body (in Malaysia it would be the Special Commissioners of Income Tax). This was made plain by the Privy Council which stated that its "jurisdiction is restricted to matters of law ...".

This was also the case in the *Malaysian Privy Council* case, *River Estates Sdn. Bhd. v. DGIR* [1950-1985] MSTC, 64 where Lord Scarman delivering the judgement of their Lordships, declared at p. 67 it was difficult to assert that either of the rival arguments represented the "true and only reasonable conclusion". Indeed in the *River Estates* case, Lord Scarman observed at p. 66 that the appellant-taxpayer had a formidable case to present. However, as the primary question was one of fact and the decision of the Special Commissioners was not unreasonable, the appeal by the taxpayer was dismissed.

Practitioners should therefore bear this in mind when advising their client - that is not sufficient merely to argue strenuously on appeal to the High Court that the taxpayer's argument is better than that of the Revenue; rather does the taxpayer's argument on facts fall within the parameters of the true and only reasonable principle? This principle itself being a rule of law. In *Lim Foo Yong's* case it did. Similarly in *Chu Lip Kong v. DGIR* [1950-1985] MSTC 58, yet another Malaysian Privy Council case.

Moreover taxpayers should not be unduly disheartened for this rule also applies when the Revenue appeals against the decision of the Special Commissioners. And this underlines the importance of obtaining tax advice early in the day not only on law but also on facts especially where they impinge on the law.

Finally the *Richfield* case should also alert "governing minds" not to be so cock a hoop about their all seeing wisdom. A hasty decision made in the first flush of fat profits can cost one dear.

JUDGMENT

Lord Jauncey of Tullichettle:

This is an appeal by a taxpayer company ("the company") from a judgment dated 9 August 1988 of the Court of Appeal of Hong Kong (Clough and Hunter JJ A. and MacDougall J) allowing an appeal by the Commissioners of Inland Revenue ("the revenue") from an order dated 10 March 1988 by Sears J which had allowed an appeal by the company by stated case from a decision of Board of Review dated 12 August 1986 rejecting the taxpayer's appeal against an assessment to profits tax for year 1979/80. That assessment related to substantial profits arising on the sale of a block of flats comprising fifteen units known as Gardena Court.

The assessment was made under s. 14 of the Inland Revenue Ordinance which applied to the year of assessment and which provided (so far as material) that:

> Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this part.

Section 68(4) of Inland Revenue Ordinance places upon an appellant the onus of proving that an assessment appealed against is incorrect. The issue between the parties has all along been whether, as the company contend, Gardena Court was at the time of sale a capital asset in which event profits accruing on a sale thereof were not chargeable to profits tax or whether it was part of the company's trading stock in which event such profits were taxable.

There was presented to the Board of Review an agreed statement of facts together with a number of appendices containing relevant documents. The Court of Appeal set out the material facts as derived from the agreed statement and the appendices and their Lordships cannot do better than repeat their exposition albeit with slight adaptation and abbreviation:

1 The company was incorporated on 22 September 1972 as a private limited company.

2 On 9 October 1972 the company entered into three sale and purchase agreement to acquire by an issue of fully paid shares some seven properties at their then market value. These properties ranged in size from a small shop in Tai On Building which was unlet to Gardena Court and included a single unit in Lungcheong Villa and eight units in a block of flats known as Kellet Heights.

3 The company has acquired no other direct interest in properties in Hong Kong or elsewhere. Its later acquisitions were all indirect through subsidiaries, and in California.

a 4 At all material times, all of the said properties have been classified as Fixed Assets in the company's Balance Sheet. Throughout the years since 1972, the company has consistently made known in its annual statement its business of long term property investment.

5 (a) In November 1972 the company became a public company.

b (b) In December 1972 the company purchased all the share equity in the Wan Shang Overseas Investment Co. Ltd. This newly acquired subsidiary owned two properties in Los Angeles, Lucerne Towers and Orange Plaza. They were then fully let: were bought for long term investment and are still owned. Since that event all the company's new indirect property investment has occurred in California.

c 6 On 20 February 1973 the company sold the property in Tai On Building which was still unlet realising a profit of HK$42,000 which was shown in its 1972/73 accounts as a capital gain. This was not at first assessed for profits tax.

7 On 22 August 1973 the company sold the property in Lungcheong Villa realising a profit of HK$90,660 which was shown in its 1973/74 accounts as a capital gain. The Inland Revenue Department in correspondence with the company's auditors challenged *d* the classification of profits realised on these two properties.

8 (a) In the end an additional assessment was made for 1972/73 in respect of the profit realised on Tai On Building and the profit realised on Lungcheong Villa was also assessed to profits tax for 1973/74 and 1974/75. The company did not lodge any objection against the said assessments. The profits tax totalled HK$33,341.

e (b) The assessments asserted "property dealing" and the charged tax appears to be based upon the difference between original cost and the price realised.

10 The company continued to claim and obtain capital allowances on the remaining five properties.

11 From 1972 the rents receivable from the properties Kellet Heights and Gardena Court, *f* until their respective dates of disposal, represented the bulk of the company's rental income.

12 (a) On 7 December 1976 the company sold one of units of property in Kellet Heights. The remaining seven units of property were sold between May 1978 and November 1978. The profits of approximately HK$2.5m realised on the sale of this property were included in the company's trading profits and assessed for profits tax. Up to the time *g* of sale the property had been fully let out.

(b) In a minute dated 28 October 1976 the board resolved to sell a unit in Kellet Heights. The profit on this of HK$196,233 apparently calculated on the difference between cost and re-sale price appeared in the company's profit and loss account for the year ending 31 March 1977.

h (c) In a minute dated 18 October 1978 the board resolved to sell the remaining seven units at Kellet Heights. The profit on these sales of HK$2,446,233, also apparently calculated on the difference between cost and re-sale price, appears in the company's profit and loss account for the year ending 31 March 1979.

(d) The company and group account for the year ending 31 March 1979 were *i* accompanied by Chairman's statements dated 9 August 1979. Both were written after the decision to sell Gardena Court referred to in para. 14 below. The statement accompanying the group accounts included the following:

While your group will continue to sell a further portion of its Hong Kong properties if favourable terms are obtained, investments in real estate in Los Angeles USA will be increased through the group's subsidiary.

13 On 3 June 1979 the company revalued its remaining properties to reflect their then estimated market value and credited to capital reserve a total revaluation surplus of HK$14,905,707 including a surplus of HK$12,567,865 in respect of Gardena Court.

14 On 12 July 1979 the company's board of directors resolved to sell Gardena Court at HK$24,500,000. The sale was completed on 31 January 1980. The book profit realised of HK$6,395,800 was shown in the company's 1979/80 accounts as surplus on disposal of capital assets. The company had let out the property for rental income from the time of its acquisition in 1972 up to the date of sale.

To the above exposition it is only necessary to add the following paragraph from the judgement of the Court of Appeal:

Until his death in February 1981 Mr. Y.M. Wong was the Chairman, the only executive director, and the governing mind of the company. The three witness who were called before the board, his daughter, Mrs. Shum, Mr. Chan and Mr. Chuang had, as the board concluded, very second-hand knowledge of the material events. The auditors who had some direct knowledge were not called. The board were we think very conscious of this position and anxious not to be unfair to the deceased.

Upon the foregoing facts the board concluded that it was the initial intention of the company to purchase and retain the seven Hong Kong properties as long term investments but they further concluded that at least by April 1978 Mr. Y.M. Wong looked upon the Hong Kong properties of the company as trading stock. In reaching this latter conclusion the board expressed the belief that:

... at sometime during the passage of time culminating in a Minute of 18 April 1978 (which clearly indicated a willingness to sell other flats in Kellet Heights), Mr. Y.M. Wong - who was the policy maker - had lost his resolve to so restrict the company's affairs and was quite willing to sell the company's properties. But, we had to ask ourselves, was he merely procuring the company to realize its investments or had he embarked the company into trading? Were it not for the submission to profits tax on the sales of the Tai On, Lungcheong & Kellet Heights, the answer would on balance have been in favour of realization.

The Court of Appeal expressed the view that in the passage which their Lordships have emphasised the Board were addressing themselves to the crucial issue in the case. Their Lordships would respectfully agree with that view. The board then went on to consider when the conversion from investment to stock-in-trade took place and said:

We were tempted to think the first sale in February 1973 of the Tai On unit at a profit of RM42,000 (tax at 15% = HK$6,300) was nothing more than the realization of an investment which should not have been there in the first place: with reluctance however we did not believe that the second-hand explanations we received - plausible though they were - can outweigh the undoubted fact that the company did submit to profits tax on that transaction and when to that fact is added the subsequent submission to tax on the profitable sales of Lungcheong Villa and the Kellet properties we did not think it was open to us to treat Tai On as a case apart.

We therefore reached the conclusion that by the time of the Tai On sale Mr. Y.M. Wong was treating all the Hong Kong properties as trading stock.

Sears J had difficulty in discovering from the stated case what were the facts which were found and what were the opinions which the board came to on those facts. He considered that the board's reasoning was illogical and that they had not addressed their minds to the real issue. He decided that the sale of Gardena Court was simply the realisation of capital assets. The Court of Appeal found some difficulty in understanding the basis of the Judge's decision and their Lordships share their dilemma. The Court of Appeal, after a careful analysis of the facts and the relevant principles of law, concluded that it could not be said that the board's factual conclusions and inferences were either unreasonable or insupportable.

It is quite clear from the decision of the board that if it had not been for the submission to profits tax on the sales of the Tai On shop, Lungcheong Villa and Kellet Heights they would have treated the sale of Gardena Court as a realisation of a capital asset. The sole question therefore in this appeal is whether they were entitled to draw the inference from the circumstances of these sales that Gardena Court had become part of the trading stock prior to its sale. A finding of fact by tax commissioners or other similar bodies charged with the hearing of appeals against assessment to tax will only be set aside by an appellate Court, whose jurisdiction is restricted to matters of law, if it appears that the body in question has acted without any evidence or upon a view of the facts which could not reasonably be supported (*Edwards v. Bairstow* [1956] AC 14, Viscount Simonds at p. 29). These principles apply not only to primary facts but to inferences drawn therefrom (*Furniss v. Dawson* [1984] AC 474, Lord Brightman at pp. 527-8). Furthermore if the primary facts as found are capable of supporting two alternative inferences it is no function of the appellate Court to substitute its preferred inference for that legitimately drawn by the body in question (*Furniss v. Dawson supra* per Lord Brightman at p. 528, *Lim Foo Yong Sdn. Bhd. v. Comptroller-General of inland revenue* [1986] STC 255, Lord Oliver of Aylmerton at p. 259a).

Their Lordships turn to consider the facts from which the board drew the crucial inferences. In the first place the Tai On shop was sold some four months after acquisition without being let and although it appeared in the company's assets as a capital transaction no challenge was made to the subsequent assessment to tax on the profits of sale. In the second place Lungcheong Villa was sold some ten months after acquisition and again although the sale was treated by the company as a capital transaction no challenge was made to the assessment to tax of a substantial amount. In the third place one unit at Kellet Heights was sold in December 1976 and the profit accruing on that sale appeared in the company's profit and loss account for the year ending 31 March 1977 thereby attracting an assessment of profits tax. In the fourth place the remaining seven units at Kellet Heights were sold between May and November 1978. Again the profit accruing on the sales appeared in the company's profit and loss account for the year ending 31 March 1979 thereby attracting an assessment to profits tax. Kellet Heights was the company's second most valuable property in Hong Kong and a very substantial amount of tax was paid respect of its sale. There was no evidence before the board to suggest that Kellet Heights had been sold for the purpose of re-investing the proceeds in real property in the USA. Indeed the accounting treatment of the sale of the property with a consequent tax liability points strongly against those in charge of the company having treated Kellet Heights as a fixed asset. As the Court of Appeal pointed out the company had no business to submit to a substantial assessment to profits tax if such assessment was on the facts unjustified. In their Lordships' view the inescapable inference from the way in which the company treated the sale of the units in Kellet Heights is that it regarded them as trading stock.

There was no finding by the board that the company had sought to treat any of the seven Hong Kong properties acquired by them in a different manner so far as investment was concerned. In these circumstances, having concluded that the company was content to be taxed on the profits accruing from the sales of the Tai On shop and Lungcheong Villa as on the sale of trading stock and that the company had effectively invited taxation on that basis in relation to the profits accruing from the sale of Kellet Heights, it was but a short step to reach the conclusion that the sale of Gardena Court was undertaken on the same basis. It could not in these circumstances be said that the board drew an inference for which there was no foundation in fact or which could not reasonably be sustained by the facts which were found.

The only remaining question is to consider whether the board were entitled to conclude that Gardena Court and the other Hong Kong properties had become trading stock prior to the sale of the Tai On shop. The board had some hesitation in reaching this conclusion but having regard to the lack of direct evidence as to the circumstances surrounding this sale they concluded that such evidence as there was outweighed by the fact of submission to the assessment. Their Lordships do not consider that they could be criticised for reaching this conclusion particularly when regard is had to subsequent events.

Their Lordships will accordingly humbly advise her Majesty that the appeal ought to be dismissed. The appellant must pay the respondent's costs.

Also found at [1990] 1 CLJ 210